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LIGHT.AS - Q1 2018 Philips Lighting NV Earnings Call

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CORPORATE PARTICIPANTS

Eric Rondolat *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Robin Jansen *Philips Lighting N.V. - Head of Investor Relations*

Stephane Rougeot *Philips Lighting N.V. - CFO and Member of the Board of Management*

CONFERENCE CALL PARTICIPANTS

Alexander Stuart Virgo *BofA Merrill Lynch, Research Division - Director*

Alok Katre *Societe Generale Cross Asset Research - Equity Analyst*

Andreas P. Willi *JP Morgan Chase & Co, Research Division - Head of the European Capital Goods*

Daniela C. R. de Carvalho e Costa *Goldman Sachs Group Inc., Research Division - MD & Head of the European Capital Goods Equity Research Team*

Marc Zwartsenburg *ING - Analyst*

Wim Gille *ABN AMRO - Analyst*

Martin Wilkie *Citigroup Inc, Research Division - Director*

Peter Reilly *Jefferies LLC, Research Division - Head of Capital Goods of Equity Research*

Peter Olofsen *Kepler Cheuvreux, Research Division - Analyst*

Sven Weier *UBS Investment Bank, Research Division - Executive Director and Analyst*

PRESENTATION

Operator

Ladies and gentlemen, welcome to the Philips Lighting Earnings call for Q1 2018. (Operator Instructions) I would now like to give the floor to Robin Jansen, Head of Investor Relations. Mr. Jansen, please go ahead.

Robin Jansen - *Philips Lighting N.V. - Head of Investor Relations*

Thank you, and good morning everyone, and welcome to the Philips Lighting earnings call for the first quarter results 2018. With me are Eric Rondolat, CEO of Philips Lighting; and Stephane Rougeot, CFO. In a moment, Eric will take you through the first quarter business and operational performance. Stephane will then tell you more about the financial performance in the first quarter and Eric will end today's presentation with our financial outlook and conclusion. After that, we will be happy to answer your questions.

Our press release and the related slide deck were published at 7.00 AM CET this morning. Both documents are now available for download from our Investor Relations website. A full transcript of this conference call will be made available as soon as possible on our Investor Relations website.

Before handing over the call to Eric, I would like to remind you of the following. As of the first quarter of 2018, Philips Lighting reports and discusses its financial performance based on the recently announced portfolio changes to further aligning the organizational structure with the strategy. In addition, we've made changes to the allocation methods of centrally-managed costs and to the threshold for other incidental items as adjusting items when presenting certain non-IFRS measures such as adjusted EBITA. In March, we published a detailed overview of these changes and the effect these changes had on prior year financials. This update can be found on and downloaded from our Investor Relations website.

With that, I will now hand over to Eric.

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Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Thank you, Robin. Good morning, everyone, and thank you for joining us today. Let's go straight to Slide 4. So the first quarter of 2018 marks a soft start of the year as indicated previously, when we announced our full-year results. This was mainly due to a weak performance in Home and most notably in the U.S.. However, the other 3 businesses delivered solid performances, total LED sales increased by 5.6%, and now represent 68% of total sales compared to 61% last year.

Looking at our margin. It was 50 basis points lower than last year, with an improvement in Lamps, LED and Professional offset by Home. We have also made good progress on the cost side, with a 13% reduction in our indirect cost base. I am pleased with our free cash flow performance after a strong fourth quarter in 2017. Excluding the real estate proceeds of EUR 19 million, our free cash flow was higher than last year.

Let's move now to Slide 5, where you can see the financial performance by business group. If we look at comparable sales growth, LED and Professional delivered positive growth. Lamps also did well as it continued to decline less than the overall conventional lamps market. However, in Home, sales declined in the quarter, which I will explain in more detail in a couple of minutes.

When we look at the profitability, you can see that Lamps, LED and Professional all improved the adjusted EBITA margin and we are especially pleased with the margin improvement of 310 basis points in Professional. The adjusted EBITA margin of Home dropped sharply, mainly due to lower fixed cost absorption and investments in growth since the first quarter of 2017.

Let me now walk you through our business groups and on Slide 6, we are starting with Lamps. Comparable sales declined by 17.6%, we estimate that the conventional lamps market continued to decline faster than our Lamps business in Q1, which has resulted in continued market share gains. Despite the declining top line, Lamps has been able to sustain a high level of profitability at 21.2%, this is 80 basis points higher than last year and driven by procurement savings, productivity and lower indirect cost.

Restructuring cost amounted to EUR 17 million in the first quarter and mainly related to the announced closure of our halogen factory in Aachen, Germany.

Let me now move to LED on Slide 7. Comparable sales increased by 3.6% on the back of a relatively high comparison base as LED experienced a strong start of the year in 2017. Growth in LED lamps remained robust with volumes gradually converging to market growth, while price erosion is reducing. LED electronic sales were flat, due to lower demand by OEMs, particularly from Tier 1 customers. The adjusted EBITA margin improved by 110 basis points to 9.6% in the first quarter, due to lower price erosion, mix improvements and lower indirect costs.

Let's move on to Professional on Slide 8. In Professional, comparable sales increased by 3.2%. Performance in Europe and the rest of the world remained solid, while market conditions in the United States continue to be soft, in particular for small- to medium-sized projects. In that part of the market, and the stock and flow business, we continue to see increased competition, specifically from low cost producers, which results in increased price pressure.

In Saudi Arabia, market conditions continue to be challenging and that negatively impacted us and our CSG by 220 basis points. The adjusted EBITA margin improved 310 basis points overall to 5.2%, mainly driven by operational leverage, the reduction of factories and lower indirect costs.

Let's now turn to Slide 9, and let's talk about Home. So Home reported a negative comparable sales growth of 6.4%. Let me provide a bit more detail on what caused this decline. So we had a very strong growth in Home systems in the third and fourth quarter of 2017. Together with our trade partners, especially in the U.S., we had even higher expectation compared to what was actually delivered. We realized that this had led to a high level of inventories at our trade partners. This resulted in lower sales in the first quarter to allow for inventory reductions at these trade partners. This low level of sales impacted our profitability in a material way in the first quarter as we were not able to fully absorb fixed costs, especially given the investment in growth since the first quarter of 2017.

We are undertaking a set of actions to improve performance over the coming quarters. We continue to broaden our product offering, diversify our distribution coverage and increase our marketing activities. Our view that the long-term growth and margin potential of connected systems for

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the Home has absolutely not changed, because of the performance in Q1. We are confident that the actions I just talked about will bring Home back on a solid growth path, which will also improve its profitability.

Taking everything into account, we expect sales also to be affected in Q2 but to return to normalized levels in the second half of the year for Home. As a result, we expect Home to return to profitability in the second half of the year and to be around breakeven for the full year.

This is what I wanted to cover regarding the business and operational performance. I will now hand over to Stephane, who will tell us more about the financial performance for the first quarter of 2018.

Stephane Rougeot - *Philips Lighting N.V. - CFO and Member of the Board of Management*

Yes. Thank you, Eric, and hello, everyone. Let me now turn to Page 11, where you can see the adjusted EBITA bridge. So the adjusted gross margin, when you look at it as a percentage of sales, decreased by 110 basis points in the first quarter compared to last year. And that was mainly due to a lower sales level, our price erosion, we saw it declining and slowing down. And it was partially offset by ongoing procurement savings although at a lower level that we previously saw.

When you look at the indirect cost, we improved by EUR 38 million, excluding currency effects, so a strong performance there. And finally, we had the negative impact from FX. This is due to the further devaluations of currencies like the Indian rupee, the Indonesian rupee, Argentinean peso and Canadian dollar in particular and these devaluations were not able to offset the favorable impact that we continue to see from the Chinese Renminbi, to some extent also the U.S. dollar.

Let's now turn to the next page on indirect cost. You can see on this slide the year-on-year developments of our adjusted indirect cost base, which was 33.2% in the first quarter of 2018. This is a 60 basis point reduction compared to the same period of last year despite also the lower sales. And we clearly see the impact of the many cost reduction initiatives that we implemented across the company. This enabled us to achieve EUR 38 million of savings in indirect cost without the ForEx effect. And overall, we have reduced by 13% our indirect cost base compared to a year ago. Of course, ForEx positively impacted the adjusted indirect cost base by an amount of EUR 35 million.

We continue to implement our multi-year transformation initiatives in order to simplify our organization, be able to improve our customer service and quality, be able to be more efficient, to capture also scale benefits and be able also to reinvest in growth. We expect these initiatives to allow us to continue to reduce our indirect cost base over the coming quarters and to reach a level of indirect costs at or below 29% by 2019.

Let's now take a look at the working capital of the first quarter on the next page. Here, again, another strong performance in the first quarter when you compare with the same period of last year, the working capital decreased by EUR 105 million and it was EUR 612 million at the end of March and that represents 9% of sales in the first quarter of 2018. This improvement compared to a year ago is mainly due to lower receivables where we had a very good collection activity in the first quarter and also a reduction in inventory of EUR 25 million.

As a percentage of sales, our inventories increased slightly by 30 basis points. After a very sharp reduction of our working capital and the strong free cash flow in the first quarter, we see another solid working capital performance in the first quarter. It allowed us to improve our free cash flow compared to the first quarter of 2017, if we exclude the real-estate proceeds of EUR 19 million that we benefited last year.

Turning to the next page, Page 14, on net debt, you can see that our net debt level increased by EUR 68 million compared to the end of 2017, of course, next to the profit that we generated during the quarter and also the change in working capital that I have just mentioned. You can see here the other items in the bridge that impacted our cash and therefore our debt. Our net CapEx was EUR 21 million in the quarter, which is a bit lower than last year and we've been very tightly managing our CapEx. Change in provision was EUR 5 million and next to that, we paid EUR 40 million for tax and interest. We also repurchased shares from Royal Philips for an amount of EUR 71 million after the sell-down, which took place at the end of February. All in all, this increased our net debt position to EUR 435 million at the end of the first quarter of 2018.

Let me now hand back to Eric for the last part of the presentation.

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Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Thank you, Stephane. Let's turn to Slide 16. So to summarize, as we indicated in January, Q1 marked a soft start of the year. This is mainly due to a weak performance in Home, while at the same time, we continue to improve profitability in the other 3 businesses. We also made good progress in reducing our indirect cost base and we improved our underlying free cash flow after a strong fourth quarter.

With respect to our outlook, so we aim to deliver positive comparable sales growth for the full year on the basis of a strong second half. Next to that, we aim to improve our adjusted EBITA margin from 9.6% to 10% to 10.5% and we will continue to focus on cost reduction initiatives. Based on that, we expect to generate solid free cash flow in 2018, which is already flagged in January, expected to be somewhat lower than the level in 2017 due to higher restructuring payments.

Restructuring cost for the year are expected to come at the high end of the targeted range of 1.5% to 2% of sales if we take into account the cost related to the company name change. For the second quarter, we expect the restructuring cost to be at a similar level as we have seen in Q1.

So with that, I would like to open the call for questions, which Stephane and I are happy to answer. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Dennis Dinkelmeyer of Goldman Sachs.

Daniela C. R. de Carvalho e Costa - *Goldman Sachs Group Inc., Research Division - MD & Head of the European Capital Goods Equity Research Team*

It's Daniela here actually from Goldman. I have one question and one follow up. To start up on the question on your point about meeting -- keeping the guidance on the 10% to 10.5% and talking about sort of indirect cost savings accelerating in the second half. I think if one sort of does the math roughly, you need EUR 100 million incremental EBITA the next 3 quarters versus what you had last year to make up the low end of your guidance. Can you talk through what you see on indirect costs and then why you're confident on that to keep the margin guidance where it is? I'll start with this and then I'll ask the follow-up.

Stephane Rougeot - *Philips Lighting N.V. - CFO and Member of the Board of Management*

Yes, sure, Daniela, let me take that one. So yes, we've always said for the last few quarters that the regulation of indirect cost is a core part of our outlook and a core part of our guidance for 2019. And we have taken a lot of actions as we have commented -- is to be the achievement. If you take into account also the ForEx effect, we are at more than EUR 70 million reduction, very clearly the trend is there for us to be able to deliver as you mentioned above EUR 100 million reduction. We're going to continue that every quarter and we indicated at the beginning of the year that we expect that the trend would even increase in the second half, as we see even higher impact of everything that we have started towards or implemented towards the end of 2017 and also in the first quarter. So, yes, that's a very important element of the outlook, and of the guidance mid-term.

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Daniela C. R. de Carvalho e Costa - *Goldman Sachs Group Inc., Research Division - MD & Head of the European Capital Goods Equity Research Team*

Okay. Would be good to have a bit more detailed color on that. But anyway I'll move to my follow-up question. On your confidence on organic growth guidance for this year, and Eric mentioned just in his speech, that this was counting on an acceleration in the second half. How much visibility do you have on this? Is there a large project, is there something that gives you the confidence?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Yes, good morning, Daniela. So as you can imagine, we looked at that very, very specifically. We did a re-forecast in detail in the past weeks. What we see at this point in time? We see that Q2 will still be affected by Home, and I can go into more details later down the track about the situation there and why I'm saying that. But we see a very strong Q3, and we see a strong Q4 on the basis of a few things. The ongoing improvement in the businesses. So you see that the other 3 businesses are performing well, and according to their strategic objectives. We believe that Home will resume also its performance on growth in Q3, and very much so in Q4. We have also the halogen ban in September. As you know, after the 15th of September, we basically cannot produce anymore. We can sell our inventory, but we cannot produce anymore. So there will be stock building by our customers from the halogen ban. So that will have an impact on the sales in Q3. And we have in some regions of the world and specifically, Saudi, as much as I don't see any improvement in the underlying trend in the economy of Saudi, I was there a few weeks ago. But we have secured some projects, 3 projects of -- interesting projects with very selective customers. As you know, one of the very important element for us in Saudi is to get paid. So we're very selective in the businesses that we take. And quite important projects that we believe are going to improve our position there and in H2. So the visibility that we have at this point in time is, Q2, which is going to be affected, a very strong Q3 and a good Q4.

Operator

Our next question comes from the line of Alok Katre of Societe Generale.

Alok Katre - *Societe Generale Cross Asset Research - Equity Analyst*

My follow-up just on the guidance side of things. I mean, if you could just talk through particularly at BG Home in terms of how the quarter has sort of shaped up as well across the month. It's clear you've been sort of obviously, flagging that the de-stocking still continues in the second quarter as well. What is the confidence behind, let's say, the return to normal levels of growth and when we think normal, I mean, what sort of normal levels of growth we should see, because this is really very volatile. And then the other question, of course, in terms of main question was, can you just talk a little bit about the U.S. and professional markets over there? Any signs that you are seeing in terms of recovery at all, because none of your peers are particularly positive on the U.S. lighting market. So maybe if you just talk about the dynamics over there, that would be great. Thanks.

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Sure. So on Home. So let me try to go back in time and explain why we are there, and how we see that business moving forward. There were a lot of expectations in Q4 and if I assume, specifically on the U.S., because this is where the major impact is. We have to understand that for Home System business, the U.S. is big proportion of that business worldwide. We are selling to important trade partners, important retailers, online, offline. So they had a plan to grow extremely aggressively in Q4. We followed them with their plans. The way we follow, well, we make sure that we have the available products. And as you can remember, that's one of the issue we had in 2016 when we didn't have enough products available. So I think they wanted also to make sure that in 2017, they would not have any shortage in terms of products. So that probably has not -- so they had these plans, we supported them in marketing activities and then we realized that they will not make the plans, but you are making the inventories for Q4, basically in September and October and actually in November. So that was done. We realized because October was very strong, November was very strong, December was strong but less, and then in January, January started to be very soft. So we analyzed a bit more the situation at that point in time, which is why we came at the end of Q4, when we announced our full-year results, we said that the quarter would be soft. Then going into more details because once again, we have different customers that we're talking to and they have different situations. With the inventory for that specific business, so we're talking about Home Systems, inventories going between 9 weeks to 18 weeks, which to give you a hint, a healthy

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inventory in the trade is around 8 weeks. So they had built that inventory and I remember one priority in Q1 was to make sure that that inventory would reduce, and to be also very specific, and that's also one part of your question, the selling out in Q1 for those customers has been good. It has been again a strong double-digit selling out. So the selling out is there, now there is another element. Q4 is 2x in volume Q1. So when you have an overshoot in Q4, and you build up inventories then it takes a big proportion on what your business is in Q1. So this is. in a nutshell, what has happened. Now what makes us confident? So first of all, there is no structural issue on that business. The re-offers are there, we continue to innovate by bringing to the market a full connected offer, not only for the inside of the home, but now for the garden, which was much awaited by customers that were asking us when we would be able to provide a compatible offer for the outdoors. So this is now going to be launched in Q2, so that's one thing. The second thing is the selling out is healthy. So it's going to take a bit of time, so that inventories are back into healthy position and then we see the business continuing to grow, to give also another hint, we've made a lot of investments for the growth plan that we had last year. So we have a carryover effect also on the investment that you have done during the year and all that is happening in Q1, on the basis of the lower top line, then it doesn't help the bottom line, as you have seen it. So I'm going to be very frank and direct, I'm not satisfied and happy by the performance we had in Home. It's probably a bit worse than what we had imagined, when we talked to you last time. Nevertheless, I'm confident on the potential of that business moving forward, and this is the plan we have in order to recover. Now that business needs to grow double-digit in order to be profitable. So that's what we see happening, and especially in the second half of the year.

Alok Katre - *Societe Generale Cross Asset Research - Equity Analyst*

Okay, thanks.

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Sorry, it was a bit of a long answer -- yes, sorry, I was a bit long on Home, but I think this deserves some explanation. Let me now answer your question on U.S. Prof. Do we see any sign of recovery on the market? The answer is no, not in Q1. So we still see the same trend on the projects that are low to mid-sized. What we've seen also in Q1 as a negative trend is the market and the public market, especially when it comes to road and street, which is a big part of what we do, we are very, very much oriented towards the outdoor part of the portfolio in the Professional part of the business. So we've seen that market slowing down in Q1. Nevertheless, when we look at the performance of our Professional business, it, of course, includes the performance that we have in the U.S. and you've seen that we're growing not only the top line, but we're also growing very healthily the bottom line in line with the plans that we had originally by 310 basis points for Q1.

Alok Katre - *Societe Generale Cross Asset Research - Equity Analyst*

Is that sort of -- then we should think about that as more Europe sort of [plays] and how sustainable then should that growth profile will be? And I'll leave it at that.

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Europe has been consistently strong, except U.K. and Ireland. China has been very strong as well as the rest of the world and I would put beside, of course, Saudi that I've already talked about.

Operator

Our next question comes from the line of Martin Wilkie.

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Martin Wilkie - *Citigroup Inc, Research Division - Director*

This is Martin at Citi. Just the first question coming back to the inventory in the channels. I mean, obviously, there's a big volume impact there. Do you take any inventory risk in terms of pricing, I mean there were some discounts that we saw at certain retailers on the Hue products running up to Christmas. I was wondering if the impact you had was purely on the volume side or if you also retained some pricing risk on the inventory in the channels? And the second follow-up question, you mentioned you need to grow at double-digit rate. You also said the sellout is healthy in the quarter. So even though you're going to see an ongoing drag in Q2 as it de-stocks, is the sellout still at the double-digit rate that you need to get to in the second half?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Yes, absolutely. Let me start with the second question. Yes, we need to continue to see a double-digit sellout and with marketing activity, we are also helping that sellout and that's the way we work with these big retailers. On your first question, there is no specific risk, which is retaining the pricing of the inventory that the customers have built up. That's not the way we work.

Martin Wilkie - *Citigroup Inc, Research Division - Director*

Okay. So it's purely volume impact from your perspective?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Absolutely.

Operator

Our next question comes from the line of Alexander Virgo of Bank of America Merrill Lynch.

Alexander Stuart Virgo - *BofA Merrill Lynch, Research Division - Director*

I wondered if you could just do a little bit more on Home, forgive me for going back to it. But could you maybe characterize how much of Q4 growth was therefore inflated because it sounds to me like the 54% growth in Q4 was probably over -- or on the fact you have underlying demand. And then perhaps talk a little bit about the visibility, because I guess your comment at the end in previous explanation about being a little bit weaker than you had expected, it sounds to me like it got a lot weaker than you expected. So I just wonder if you could talk about the visibility that you have on that?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

So on your first question, it's a very difficult thing to say at this point in time, because it depends on many different factors, and really a few customers. So I don't have any concrete answer. And also depending on the dynamic that you see in the upcoming quarter. But there's one, which is very important to consider, which I've already talked about. Q4 is 2x Q1 in general and there was an expectation from these customers to grow much beyond what has already been achieved, and which was a great growth, if you look at our growth in Q4. So they decided to go for the big game, let's put it like that. We have plans to achieve it and it didn't happen. Now, maturity we don't have a very precise number to give. So I would give you the development on the matter was in the following way. So we understood that October was strong, November was very strong, December was the bit weaker, so that was the first thing, so we looked into it and the beginning of the year was also soft on the back of lot of different festive activities all around the world. So there was still some traction there. But then we realized that we would be facing a softer situation in Q1. Then at the end of Q1, I would say -- at the end of January or beginning of February, we started to investigate and go back to our customers to understand what actually was going on. And I can give you more precise examples. Some of those customers -- online it's a bit easier, but offline they have

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thousands of retail points, so we need to have the information of what was going all over the place. And when you look at our customer, they had a very strong, smart home business in Q4, pretty much in line what their target was. The lighting piece was not, so they proactively came to us telling us, hey, there's something happening on the lighting business, because overall the smart home business was moving in the expected direction. But the lighting piece was lower than expectation. So it took us probably after the beginning of February, close to 4 to 5 weeks, to really go into the details, and have a good evaluation of what was going on. So this is what happened, we discovered it moving in the quarter. Now as I've said before, I'm not happy about it, I think we should have seen that faster, that's the message that we've given to the teams and if we have from this situation an important learning, that is when we have businesses that don't go well, or businesses that go too well, we need to equally watch both of them and probably that's where our attention was more, on the businesses that needed improvement than on the Home and I would say the Home System part of the business that was flagged at this point in time. But this is how these events occurred all along the quarter.

Alexander Stuart Virgo - *BofA Merrill Lynch, Research Division - Director*

And maybe just as a follow-up then. When you talk about Q2 being still affected and growth normalizing in the second half, would it be fair to assume that the business Home will still decline in Q2, or would it be more flattish? And then, obviously you've got a meaningful step up in comparative growth in the second half, 45% and 54% respectively, Q3 and Q4. You are talking double-digit growth on those comps, is that right?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Yes, we don't see Home declining in Q2. We see Home growing in Q2, but not at the levels that we originally estimated in our target. So there will be an improvement in home Q2 versus Q1, but still not at the level where we believe that that business needs to be.

Operator

Our next question comes from the line of Sven Weier of UBS.

Sven Weier - *UBS Investment Bank, Research Division - Executive Director and Analyst*

My first question is actually on the LED component part of the business and where you are also supplying to other people. Is the observation that maybe the destocking that you saw from your customers there has now come to an end and has normalized that would be my first question?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

On the LED electronics, the situation that we see is still a very soft market when it comes to our Tier I customers, mainly -- to cut a long story short, the big luminaire manufacturers. On the other hand, we had a stated goal to develop also our business strongly to Tier 2 and Tier 3 customers and if I'm simplistic, these are the smaller luminaire manufacturers. So what we see, we see that we have from still lower base a very dynamic growth when it comes to the Tier 2 and Tier 3 customers but we are enjoying much less sales growth than originally expected on the Tier 1 customers. So that's the situation. We haven't seen any improvement in Q1 versus what we did experience in the previous quarters and this is what we had guided for, so it has continued basically in Q1.

Sven Weier - *UBS Investment Bank, Research Division - Executive Director and Analyst*

And is that also because of more competition from lower cost competitors or is it just purely related to the softness in the market?

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Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

I think that this is a very good question and I believe there is a bit of both. But certainly that we see new low cost actions on the luminaire side of the business, which are challenging, probably established and historical layers and something we've fully integrated. Luminaire, meaning that you have not only the luminaire, the LED engine, but also the driver, what we call components in it, and that has an impact on the original way of doing business. Looking very specifically at that situation today, and we're doing a lot of strategy deep dive to understand what's happening on the market and who are the involved actors and we are preparing a set of action and initiatives in order to be able to include in when and wherever necessary. But this is something that we're looking at this point in time, so if you ask me today, [without] being able to give you a very clear indication in terms of quantitative information, I believe there is a bit of both. Market softness on the one hand, but also some of the markets we have taken at the low end of the market by new actions in the LED space and luminaire space.

Sven Weier - *UBS Investment Bank, Research Division - Executive Director and Analyst*

And the second follow-up question I had was on your LED chip procurement. So where you are the Tier 1 customer to your suppliers, has your behavior changed there? How is your stocking situation on LED chips, do you feel you can destock yourself and how do you see pricing evolving at the moment, because there's been some talks about price reductions from the Chinese suppliers, for example, are you seeing that spreading also to these suppliers like luminaires, that would be my second question?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

So on the chip side, you have 2 different situations you have the high power, which has reduced compared to what it used to be a few years ago and you have, medium power LEDs and also low power LEDs, which are taking the biggest stock of our procurement volume at this point in time. I think we have worked fairly well on the management of our suppliers when it comes to chip manufacturers. So we are concentrating our volumes on some strategic suppliers, working with them not only on the pure customer to supplier base, but also co-designing with been in order to be able to achieve together some of the desired performance that we believe we need to be able to compete and bring promise to our customers. So we're doing that quite well. We are still enjoying at this point in time price decrease on the chip, but much less than what was happening previously, doing 2 things. So first of all, co-designing and making sure that we have the right product for us and then committing on volume to those customers and also by selecting them very, very sharply based on the capabilities for the different applications that we need. So that's one part of the business that runs pretty well, at the same time we have a big volume to sell. So we have worked well on improving it and that helps us to have the right supplier base for that very specific [customer] would be raw material.

Sven Weier - *UBS Investment Bank, Research Division - Executive Director and Analyst*

But there's no change on your behalf in terms of your procurement that you have slowed it down or any change on your procurement behavior in general?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

No. On the contrary, if you look at the volume, I mean, this is still going up.

Sven Weier - *UBS Investment Bank, Research Division - Executive Director and Analyst*

I was just wondering as a side effect maybe of the slower business [that could affect].

Operator

Our next comes from the line of Peter Reilly all of Jefferies.

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Peter Reilly - *Jefferies LLC, Research Division - Head of Capital Goods of Equity Research*

I've got one and a follow-up please. Firstly on your LED business, growth rate continues to slow, I know some of that is the LED electronics, but can you tell us if all countries are still showing growth in LED lamps or whether any of this markets have become mature and started to shrink? And then secondly, on the follow-up, you mentioned that your U.S. professional business, a lot of it is road and street, do you know what the penetration is now of LEDs in the installed base? The street lights in the U.S., I guess, is going up fairly rapidly. My assumption is that at some stage that reaches maturity and then you have a very long period when the market is very soft. Maybe you could talk about those 2 issues please and help us understand the trends?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Sure, Peter. Thank you. When it comes to the LED business, so the LED business has got 2 components as you know, one is LED electronics, less than half of the business, and the other one is LED lamps. LED electronics is flat, as I've mentioned before, so LED lamps is growing in Q1. And we have to put that in perspective of the high base of conversion in Q1 2017 and specifically in the region of Asia, to mention India, where we were taking big projects in terms of LED Lamps. So we knew that the base of comparison and this is what we also highlighted in the previous announcement would be strong for LED lamps. Now we see it LED lamps growing in all the countries, where we operate. I would say there maybe 1 specific example, but otherwise we see still LED lamps growing in all the geographies. Of course, as we've mentioned before, in markets where the penetration of LED is high, we see less growth than in the markets where the LED penetration is lower. In Northern Europe, we have less growth in LED because the penetration rate is much higher than you would have in some merging countries that have been moving to LED later, but that's the same comment as what we have said previously. On the Professional side of the business, I'm going to give you at the top of my head statistics on street lighting, we believe that between 15% to 20% max of the existing street light poles on the planet have been updated with LED energy efficient lighting. We count, but it's a [small] statistic. So maybe it has evolved, at the tip of [9/9], we talk about 300 million light poles on the planet and probably 15% to 20% of that in mature countries as a max have moved to LED. So you see the potential is still extremely strong and high and when you talk about connectivity, it's even less, it's probably less than 3%.

Peter Reilly - *Jefferies LLC, Research Division - Head of Capital Goods of Equity Research*

Do you have that number for the States and the reason I'm asking you is, obviously, the U.S. Professional business has had problems and my guess would be that the penetration is much higher than 15%, 20% in the U.S.. And therefore you can see relatively soon, where the market actually starts to go into decline because when you get to, I don't know, over 70% or 80%, the change in the market is going to be a lot smaller. So do you know what the penetration rate is in the States?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

No, Peter. I don't know it at the top of my mind. My guess is that it's certainly lower than Europe. And I will not share that view, I think that there's a lot to do still in the U.S. when it comes to street and road lighting. I see that the conversion there is now happening but it hasn't been as fast as what we've seen in Europe.

Operator

Our next question comes from the line of Peter Olofsen of Kepler Cheuvreux.

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Peter Olofsen - *Kepler Cheuvreux, Research Division - Analyst*

I have a question on the pricing trend and the cost of goods sold trend because I think they are largely linked. In the press release, you mentioned that the price erosion is slowing. Is that mainly in the LED segment or do you also see it in other segments? And it seems that the cost of goods sold reduction is getting more moderate. Can you confirm, it's indeed becoming more difficult to reduce the bill of materials. Thank you.

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Yes. so Peter, let me take that one. So on the price reduction, indeed, I think we've mentioned that already in Q4 but in Q1, we have also seen on the LED lamp side, a slowdown of the price decrease. So we see that continuing and we expect this to continue and I think we've mentioned that a few times. When you look at the bridge and the overall price effect, it's still relatively high. We've seen in professional some increased price pressure. So the slowdown of price reduction in LED has been unfortunately somewhat compensated by some higher price reductions that we have seen, especially in Professional. Going to the cost of goods sold, which includes bill of materials and productivity, yes, in Q1, the overall amount that we have saved is lower than what we used to save every quarter. I think we have always indicated that, especially in LED, as we see less volume growth and also as the technology matures, there will be less saving extracted on the bill of materials and that's going to come pretty much in sync also with the lower price reduction. And this is exactly what we see happening. Now Q1 is always a bit of a lower quarter when it comes to overall bill of materials savings compared to the other quarters. And then finally, because of the low volumes, that affected overall productivity. And where we usually enjoy some positive productivity effect here, there were some negative productivity effect. So that explains why that one is a bit smaller compared to what we used to have.

Peter Olofsen - *Kepler Cheuvreux, Research Division - Analyst*

Okay. And then maybe to clarify what you said on Professional, that has a bit more price erosion than you saw before. Is that mainly on the lower end and is that due to imports from Asia into Europe and U.S. or what's driving that?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

So, yes, first, we pretty much see that on the lower end of the trends in LED, of course. It's, we believe, pretty much driven as well by the Chinese imports or Chinese players acting on those markets, and we see a difference more in the U.S. than in Europe.

Peter Olofsen - *Kepler Cheuvreux, Research Division - Analyst*

Okay, that's helpful. Then may be a follow-up on Home. You said that your trade partners saw their overall smart home business in line with expectations in Q4, but that the lighting part fell short. What conclusion do you drove from that? Do you need to better educate the end consumer about the benefit of your product, or you have to adjust pricing? So, yes, basically what's the implication from that shortfall of lighting within the overall smart home category?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

So that's a conclusion, the first one is, I think the objective for the lighting was extremely ambitious, and in retrospective too ambitious. That doesn't mean that lighting didn't sell, we sold a lot and they sold a lot. But they had even higher expectations. But we saw, not for all of them, I was really mentioning one very specifically, what we saw is that in Q4, a lot of offers came on the market for smart home and security in smart home. And I believe that, as much as they didn't reach their objective, that was a very, very high one for lighting. They probably sold more than what they had expected in security for the smart home. So these are the 2 learnings from what happened. Now just to be clear, we cannot talk about an actual shortfall in the lighting business because the growth was high, it's just that they had even higher ambitions.

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Operator

Our next question comes from the line of Marc Zwartsenburg of ING.

Marc Zwartsenburg - *ING - Analyst*

I have a question about Prof. You mentioned the 3 larger contracts kicking in in the second half. Can you give some indication if you will then reach double-digit growth in that division? Can you give a bit more detail on how we should think about the growth and margins in Prof in the second half?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Marc, we're not specifically commenting by business and specific guidance for the year. But you look at the improvement inside of Prof. So we want to continue to move that business towards the guidance that we have given for the mid-term, and we believe that business will see a strong Q3 and again a good Q4. We are not specifically giving number by business and by the year. But as you can see the trend in Q1 is positive and we continue to be positive on that business for the upcoming quarters.

Marc Zwartsenburg - *ING - Analyst*

To be fair, on Q1, you see a bit of a slowdown in the trends. And you mentioned also some softness in the U.S. public market. So somewhere to achieve your at least 0% comparable sales growth. There should be some acceleration in the Prof business. So perhaps you can give a bit more color on why we should see an acceleration of growth in Prof in the second half and how sizable those projects roughly would add to the growth?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

The way I look at it, Marc, is in the following fashion. So we're growing in Q1 about 3%. We still have the negative impact of Saudi. It is also a business, which has a component, which is declining, which is the conventional part of the Professional business. So despite that, we are growing. And I think that's a reasonable level of growth for that type of business. While at the same time, and it's extremely important to us, we are improving on the bottom line and it's an improvement of 310 basis points, and we have to look at it quarter-to-quarter. And we were expecting and we're expecting not only Q1 but also H1 to provide an improved performance from the bottom line perspective, and this is what is happening in Q1. So this is why we see this as being a good start.

Marc Zwartsenburg - *ING - Analyst*

I agree on the margin but I'm more referring to your guidance on your top line and that is 0 while we see the trend in the Home, somewhere we need some compensation. And the trend to be fair, although Prof is still growing, the trend came from say mid to high single-digits to say low single-digits and there have been some clouds arising on the public side. There should be some compensation from something else to make you comfortable with your full-year guidance on the top line, and that's why I would like to have a bit more color on what we can expect for Prof in the second half of the year?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Marc, we are giving a full-year guidance on the company. We're not giving it by businesses and I have explained, the mechanism that we have in terms of the top line, we need to add a compensation of the decline of Lamps with the other businesses, and we need you know a strong Home, we need a good LED and we need a good Professional, and when that doesn't happen because one of the cylinder is not really delivering what's expected, then we have issues and this is what we've seen in Q1. But once again, the plan that we have and I'm going to come back to that and we are not giving a clear indication by businesses, because we don't do this. But it's still somewhat an impact in Q2, a very strong Q3, and a strong

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Q4,, this is what we see, and what makes us believe and remain confident in the outlook that we have given from a top line perspective, which is that the company will be growing in 2018.

Marc Zwartsenburg - *ING - Analyst*

May be then a follow-up. Can you give us also the impact from FX on your EBITA margin in Q1, what the FX impact was from ForEx in the EBITA margin?

Stephane Rougeot - *Philips Lighting N.V. - CFO and Member of the Board of Management*

So yes. So as you saw from the bridge, it's EUR 13 million. So when you take into account negative EUR 13 million and I explained on that page, it was largely related to a lot of the currency devaluations compared to last year. When you look at the sales impact, it was EUR 120 million. So when you look at the margin, it was 30 basis points. So it means if we had been at the same ForEx, the margin [level] compared to last year would have been 20 basis points and then ForEx added 30 basis point.

Operator

Next question is from the line of Wim Gille of ABN AMRO.

Wim Gille - *ABN AMRO - Analyst*

I got 2 question indeed. First of all, you indicated that the sellout at the channel in Home was double-digit, but there's still kind of very vague statements compared to the north of 30%, 40% that you generated in the sales in the last quarters. So can you be a bit more specific what the sell-out at the channel was in the fourth quarter of last year and in the first quarter of this year to give us a bit of a feeling where the lighting market really is? And the second question that I have is on the restructuring charges. You had quite a bit of restructuring charges in the first quarter, I think it was EUR 47 million, sorry EUR 43 million, you indicated that you expect a similar amount in the second quarter. Can you give us a bit of feeling where we should end up for the full-year?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Yes, let me take the sellout question and Stephane will take the restructuring one. Let's not talk about Q4, but let's talk about Q1 because this is what matters linked to reduction of inventory. The sellout that we see, was very close to the number that you have stated.

Wim Gille - *ABN AMRO - Analyst*

So 30%-ish?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Yes. It's 30% to 40%.

Operator

Our next question comes from...

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Stephane Rougeot - *Philips Lighting N.V. - CFO and Member of the Board of Management*

Sorry, just to answer the your question of restructuring, Wim. As usual, we took EUR 39 million in the first quarter. The last part of it is related to the closing of a factory in Germany, which is related to halogen and that will happen in the second half of the year, but we took the charge in Q1. And then there was a few other charges that we took related our cost reduction programs, and we've indicated, and Eric mentioned that in the presentation, that we expect in Q2 to book in our P&L a restructuring amount, which is probably around the same level as in Q1. And then for the whole year, we intend to be around the same level in absolute value compared to last year, in terms of P&L impact, that is within the range of the 1.5% to 2%. So it means that in the second half compared to last year, we will have less restructuring charge because a lot will have been booked in Q1 and in Q2. This is what we see at this stage with respect to restructuring.

Unidentified Analyst

Okay, and just to be completely clear, what was the number of restructuring charges in 2017?

Stephane Rougeot - *Philips Lighting N.V. - CFO and Member of the Board of Management*

It was EUR 126 million.

Operator

We will now go to our last question from the line of Andreas Willi of JPMorgan Cazenove.

Andreas P. Willi - *JP Morgan Chase & Co, Research Division - Head of the European Capital Goods*

Just a quick follow-up question on Home. Is there a technology shift happening in the market in terms of -- we're seeing some competitors launch connected lighting products that don't need to bridge, that are simpler, with fewer functionality, where you directly link the bulb to basically the WiFi and your app on the phone and you don't need a bridge, but also even don't have some of the capabilities as well. Is that a shift within the market to kind of simpler connected lightning that's impacting the business as well? And then a second question on Home. I assume most people that buy the Home product then download the Hue product and download the app, shouldn't that allow you to give a very almost kind of day by day tracking of what's happening in terms of real end demand. So I'm a bit surprised that basically it took until March to see the full extent of the slowdown given that the product should be connected to your app when customers actually buy and install them?

Eric Rondolat - *Philips Lighting N.V. - Chairman of the Board of Management and CEO*

Good morning, Andreas. Let me answer to the 2 questions. It's not a major technology shift, meaning that the overall market goes towards direct and easier connectivity directly over the phone. So we see it and we see it more important in Asia than in Europe. We think that this is a trend, which is more acute in this part of the world. So we are working on it. We also believe that these are the direct connection to the phone and it's a Bluetooth connection, has got advantages and drawback. So it seems effectively simpler, but it means that you systematically need to use your phone in order to activate your lighting while at the same time you are more limited in terms of functionality that you can drive out from the system. So let me give you a very specific hint, something that we believe in. We believe that at one stage, people do not want to systematically rely on their smart device whether it is a phone, whether it's a tablets, to modify their light settings. So this is why we have also battery-less switches. This is why we have motion sensors that are helping in terms of making sure that whatever you want to have it seen in your kitchen, I mean, you don't need to go back to your smart device and activate it, it's been activated pushing on the switch. So you've programmed the scene and then you can activate them simply. And moving forward, we believe that the less we can use technology to have the lighting to adapt to whatever you want to do is the right trend. So it's not a technology shift, it's another need from the customers, and we are seriously looking into it. But we think that it's not one or the other, it's probably both, and what we have started to do with the solidity of the architecture that we have, because what we

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need to understand is that you have the bridge, and on one side it's an open API that allow ad developers to create apps and that has been an important part of the success. And on the other side of the bridge is the wireless connectivity to the lamp and the possibility to command all the lamps, that architecture is very solid because it's flexible on one side, and quite rigid on the other side, protecting against security issues. So I think it's going to be the greatest [in terms] of both, and we don't see a major technology shift from that and we're looking into it. It is impossible for us [through the new app to do what you are suggesting

We don't know where people buy anyway, so it's not because they have a product that it actually indicates where that product was bought, it depends where people actually connect the product. And we don't have these type of intelligence that is to be able to very precisely indicate where products are bought and where they are installed. So we don't do that, but where you are right, is that we should have seen that earlier and the only way for us to have been able to do that and see the trend earlier was to be closer to our customers, and especially the big ones that I've been mentioning getting information on their inventory situation. Once again, this is a learning but that could not be done digitally through the app, we should have been closer to the customers to understand the trend quicker. That's a fact.

Operator

Thank you very much. And I'd now like to return the call to our speakers.

Robin Jansen - *Philips Lighting N.V. - Head of Investor Relations*

Thank you very much, operator. Thank you everybody for attending the call and for your questions, and we're looking forward to [follow the] interaction in the coming months. Have a nice day.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you very much for attending. You may now disconnect your lines.

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